89-1910

(1)

CASE NO. _____

IN THE
SUPREME COURT of the UNITED STATES

October Term, 1989

JOANNE LIMBACH,
TAX COMMISSIONER OF OHIO,

Petitioner,

v.

AMERICAN HOME PRODUCTS CORPORATION,

Respondent,

ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF OHIO

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

I. WHETHER INCOME FROM THE SHORT-TERM INVESTMENT OF ACCUMULATED EARNINGS, WHICH A CORPORATION HOLDS AS A RESERVIOR OF CAPITAL FOR USE IN ITS BUSINESS OPERATION, CONSTITUTES UNITARY INCOME, THE APPORTIONMENT OF WHICH IS NOT PROHIBITED BY THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT OF THE UNITED STATES CONSTITUTION.

PARTIES

The petitioner in this action is Joanne Limbach in her capacity as Tax Commissioner of Ohio. The respondent is American Home Products Corporation.

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DECISIONS BELOW

The Opinion of the Ohio Supreme Court is reported at *American Home Products Corp. v. Limbach* (1990), 49 Ohio St. 3d 158. (A-2). The Decision and Order of the Ohio Board of Tax Appeals is unreported. (A-9).

JURISDICTION

The Opinion of the Ohio Supreme Court was entered as its judgment on March 7, 1990 (A-2), and this Petition for Certiorari is being filed within 90 days of that date. The jurisdiction of this Court in invoked under 28 U.S.C. §1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the Fourteenth Amendment, Section 1, of the United States Constitution Ohio Revised Code Section (R.C.) 5733.05 and Ohio Revised Code Section (R.C.) 5733.051.

Fourteenth Amendment, Section 1, United States Constitution:

SECTION 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Revised Code §5733.05:

§5733.05 [Determination of the value of issued and outstanding stock; and intangible property; determination of the net income of the corporation.]

The annual corporation report determines the value of the issued and outstanding shares of stock of the taxpayer, which under division (A) or (B) of this section is the base or measure of the franchise tax liability. Such determination shall be made as of the date shown by the report to have been the beginning of the corporation's annual accounting period that includes the first day of January of the tax year. For the purpose of this section, the value of the issued and outstanding shares of stock of any such corporation shall be deemed to be the value as calculated in accordance with either division (A) or (B) of this section.

(A) The total value, as shown by the books of the company, of its capital, surplus, whether earned or unearned, undivided profits, and reserves, but exclusive of:

(1) Reserves for accounts receivable, depreciation depletion and any other valuation reserves with respect to

specific assets;

(2) Taxes due and payable during the year for which such report was made;

(3) Voting stock and participation certificates in corporations chartered pursuant to the "Farm Credit Act of 1971," 85 Stat. 597, 12 U.S.C. 2091, or as hereafter amended;

(4) Good will, appreciation, and abandoned property as set up in the annual report of the corporation, when accompanied by a certified balance sheet of the company. Such balance sheet shall not be a part of the public records, but shall be a confidential report for use of the commissioner only;

(5) A portion of the value of the issued and outstanding shares of stock of such corporation equal to the amount obtained by multiplying such value by the quotient obtained by;

(a) Dividing (1) the amount of the corporation's assets, as shown on its books, represented by investments in the capital stock and indebtedness of public utilities of which at least eighty per cent of the utility's issued and outstanding common stock is owned by the corporation by (2) the total assets of such corporation as shown on its books;

(b) Dividing (1) the amount of the corporation's assets, as shown on its books, represented by investments in the capital stock and indebtedness of insurance companies of which at least eighty per cent of the insurance company's issued and outstanding common stock is owned by the corporation by (2) the total assets of such corporation as shown on its books;

(d) Dividing, in the case of a corporation defined to be and qualifying as a "regulated investment company" under section 851 of the Internal Revenue Code, (1) four-fifths of such corporation's assets as shown on its books by (2) the total assets of such corporation as shown on its books.

(6) Land that has been determined pursuant to section 5713.31 of the Revised Code by the county auditor of the county in which such land is located to be devoted exclusively to agricultural use as of the first Monday of June in the corporation's taxable year.

The commissioner shall then determine the base upon which that portion of the fee provided for in division (C) of

section 5733.06 of the Revised Code shall be computed as follows: divide into two equal parts the value as determined in division (A) of this section of the issued and outstanding shares of stock of each corporation filing such report; take one part and multiply by a fraction whose numerator is the net book value of all the corporation's property owned or used by it in this state, and whose denominator is the net book value of all its property wherever situated, in each case eliminating, to the extent included, the investments in the capital stock or in the indebtedness of public utilities, insurance companies and financial institutions as described in division (A)(4) of this section and any item of good will, appreciation, and abandoned property; take the other part and multiply by a fraction whose numerator is the value of the business done, measured by sales of tangible personal property, by the corporation in this state during the year preceding the date of the commencement of its current annual accounting period, and whose denominator is the total value of its business, measured by sales of tangible personal property, during said year wherever transacted.

To the extent that the value of business done in this state is measured by sales of tangible personal property, it shall, for the purpose of this section and of section 5733.03 of the Revised Code, mean sales where such property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has been completed shall be considered as the place at which such property is received by the purchaser. Direct delivery in this state, other than for purposes of transportation, to a person or firm designated by a purchaser constitutes delivery to the purchaser in this state and direct delivery outside this state to a person or firm designated by a purchaser does not constitute delivery to the purchaser in this state, regardless of where title passes or other conditions of sale.

In the case of corporations whose business does not consist of the making of sales of tangible personal property and to which the sales numerator and denominator cannot apply, but which business consists of such activities as receiving commissions, rents, interest, dividends, and fees,

the fraction shall be determined by allocating such business activities in and out of this state according to their situs.

In determining the numerator and denominator of the value of the business done fraction [factor] in the case of a reporting corporation owning at least eighty per cent of the issued and outstanding common stock of one or more public utilities or insurance companies, and in the case of a reporting corporation owning at least twenty-five per cent of the issued and outstanding common stock of one or more financial institutions, receipts received by the reporting corporation from such utilities, insurance companies, and financial institutions shall be eliminated.

In determining the value of intangible property, including capital investments, owned or used in this state by either a domestic or foreign corporation, the commissioner shall be guided by sections 5709.02 and 5709.03 of the Revised Code, except that investments in the capital stock of or loans and advances to subsidiary corporations at least fifty-one per cent of whose common stock is owned by the reporting corporation shall be allocated in and out of state in accordance with the value of physical property in and out of the state representing such investments, loans, and advances.

As used in this section, "public utility" or 'utility" means a public utility as defined in Chapter 5727. of the Revised Code whether such utility is dong business in this state or elsewhere. "Insurance company" means an insurance company as defined in Chapter 5725. of the Revised Code.

(B) The sum of the corporation's net income, during the year or portion thereof preceding the date of commencement of its annual accounting period that includes the first day of January of the tax year, allocated or apportioned to this state as follows:

(1) The net income allocated to this state as provided by division (A) of section 5733.051 [5733.05.1] of the Revised Code;

(2) The amount of Ohio apportioned net income from sources other than those allocated under division (A) of section 5733.051 [5733.05.1] of the Revised Code, which shall be determined by multiplying the corporation's net income by a fraction, the numerator of which is the property factor

plus the payroll factor plus the sales factor, and the denominator of which is three, provided that the denominator of three shall be reduced by the number of fractions which have a denominator of zero. The property, payroll, and sales factors shall be determined as follows:

(a) The property factor is a fraction the numerator of which is the average value of the corporation's real and tangible personal property owned or rented, and used in the trade or business in this state during the taxable year, and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented, and used in the trade or business everywhere during such year. There shall be excluded from the numerator and denominator of the property factor the original cost of property within Ohio with respect to which a "pollution control facility" certificate has been issued pursuant to section 5709.21 of the Revised Code or an, "industrial water pollution control certificate" has been issued pursuant to section 6111.31 of the Revised Code.

(i) Property owned by the corporation is valued at its original cost. Property rented by the corporation is valued at eight times the net annual rental rate. "Net annual rental rate" means the annual rental rate paid by the corporation less any annual rental rate received by the corporation from subrentals.

(ii) The average value of property shall be determined by averaging the values at the beginning and the end of the taxable year, but the tax commissioner may require the averaging of monthly values during the taxable year, if reasonably required to reflect properly the average value of the corporation's property.

(b) The payroll factor is a fraction the numerator of which is the total amount paid in this state during the taxable year by the corporation for compensation, and the denominator of which is the total compensation paid everywhere by the corporation during such year:

(i) Compensation means any form of remuneration paid to an employee for personal services.

(ii) Compensation is paid in this state if: (1) the recipient's service is performed entirely within this state, (2) the recipient's service is performed both within and without

this state, but the service performed without this state is incidental to the recipient's service within this state, (3) some of the service is performed within this state and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the recipient's residence is in this state.

(iii) Compensation is paid in this state to any employee of a common or contract motor carrier corporation, who performs his regularly assigned duties on a motor vehicle in more than one state, in the same ratio by which the mileage traveled by such employee within the state bears to the total mileage traveled by such employee everywhere during the taxable year.

(c) The sales factor is a fraction the numerator of which is the value of business done, measured by sales of tangible personal property in this state by the corporation during the taxable year, and the denominator of which is the total value of its business done, measured by sales of tangible personal property by the corporation everywhere during such year. In determining the numerator and denominator of the sales factor, in the case of a reporting corporation owning at least eighty per cent of the issued and outstanding common stock of one or more public utilities, insurance companies, or in the case of financial institutions, owning at least twenty-five per cent of the issued and outstanding common stock of one or more financial institutions reciepts received by the reporting corporation from such utilities, insurance companies, or financial institutions shall be eliminated.

To the extent that the value of business does on this state is measured by sales of tangible personal property, it shall, for the purpose of this section and section 5733.03 of the Revised Code, mean sales where such property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has been completed shall be considered as the place at which such property is received by the purchaser. Direct delivery in this state, other than for purposes of transportation, to a person or firm designated by a purchaser constitutes delivery to

the purchaser in this state and direct delivery outside this state to a person or firm designated by a purchaser does not constitute delivery to the purchaser in this state, regardless of where title passes or other conditions of sale.

Sales, other than sales of tangible personal property, are in this state if either:

(i) The income-producing activity is performed in this state;

(ii) The income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed within this state than in any other state, based on costs of performance. If the income-producing activity involves the solicitation of a sale, the location of the solicitation shall control If the sale is principally solicited by the taxpayer or his agent from an office within Ohio, such activity shall be allocated to Ohio. If the sale is principally solicited by the taxpayer or his agent from an office outside Ohio, such activity shall not be allocated to Ohio.

(d) If the allocation and apportionment provisions of division (B) of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may request, which request must be in writing and must accompany the report, or the tax commissioner may require, in respect to all or any part of the taxpayer's allocated or apportioned base, if reasonable, any one or more of the following:

(i) Separate accounting;

(ii) The exclusion of any one or more of the factors;

(iii) The inclusion of one or more additional factors, which will fairly represent the taxpayer's allocated or apportioned base in this state.

An alternative method will be effective only with approval by the tax commissioner.

Revised Code §5733.051:

§5733.051 Taxation of net income of a corporation.

(A) Net income of a corporation subject to the tax imposed by this chapter shall be allocated and apportioned to this state as follows:

(1) Net rents and royalties from real property located in this state are allocable to this state;

(2) Net rents and royalties from tangible personal property, to the extent such property is utilized in this state, are allocable to this state, if the taxpayer is otherwise subject to the tax provided by this chapter;

(3) Capital gains and losses from the sale or other disposition of real property located in this state are allocable to this state;

(4) Capital gains and losses from the sale or other disposition of tangible personal property are allocable to this state if the property had a situs in this state at the time of sale, and the taxpayer is otherwise subject to the tax imposed by this chapter;

(5) Capital gains and losses from the sale or other disposition of intangible personal property which may produce income enumerated in subdivision (6) of this division shall be allocated on the same basis as set forth in such subdivision. Capital gains and losses from the sale or other disposition of all other intangible personal property shall be allocated on the basis of commercial situs;

(6) Dividends, which are not otherwise deducted or excluded from net income, shall be apportioned to this state in accordance with the ratio which the book value of the physical assets of the payor thereof located in this state bear to the book value of the total physical assets of the payor thereof located everywhere. Dividends received from payors, the location of whose physical assets is not available to the taxpayer, shall be apportioned as provided in subdivision (8) of this division;

(7) Patent and copyright royalties and technical assistance fees, not representing the principal source of gross receipts of the taxpayer, are allocable to this state to the extent that the activity of the payor thereof, giving

rise to the payment, takes place in this state;

(8) Any other net income, from sources other than those enumerated in subdivisions (1) to (7), inclusive, of this division, shall be allocated to this state on the basis of the apportionment mechanism provided in division (B) of section 5733.05 of the Revised Code.

NO. _____

IN THE
SUPREME COURT of the UNITED STATES

JOANNE LIMBACH,
TAX COMMISSIONER OF OHIO,

Petitioner.

v.

AMERICAN HOME PRODUCTS CORPORATION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF OHIO

Petitioner, the Tax Commissioner of Ohio, respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the Supreme Court of Ohio entered in this case.

STATEMENT OF THE CASE

This case originated in the Ohio Board of Tax Appeals as the result of an appeal by the American Home Products Corporation (hereinafter referred to as AHP) from certificates of final determination issued by the Tax Commissioner of Ohio respecting AHP's Ohio corporation franchise tax liability for the tax years 1980 through 1983. The certificates had affirmed the inclusion of AHP's short-term investment income in the formula for computing its "Ohio apportioned net income." Under Ohio Revised Code Section 5733.05 and Ohio Revised Code Section 5733.051, such income, along with income allocated to Ohio, comprises the net income base used in calculating a taxpayer's Ohio corporation franchise tax liability. In its appeal to the Ohio Board of Tax Appeals, AHP claimed that the short-term investment income was nonunitary and nonapportionable to Ohio under the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States.

The appeal to the Board of Tax Appeals was presented and considered on a record which included both a transcript developed before the Tax Commissioner and the record of evidence presented at the Board's hearing. Among other things, the Board of Tax Appeals found that AHP is a Delaware corporation with its principal office in New York, New York, and is qualified to do business in the manufacture and marketing of prescription drugs, medical supplies, packaged medicines, foods, household products, and housewares. In Ohio at the time in question, AHP manufactured consumer products at four Ohio plants, stored products in various Ohio warehouses, and operated sales offices in four Ohio cities.

As a result of profitable operations, AHP accumulated funds which it invested in short-term certificates of deposit, commercial paper and government obligations. These investments were managed by a portfolio manager under the supervision of the corporate treasurer. Of the income which it derived from these investments, AHP conceded a portion to be unitary income from the investment of working capital, apportionable to Ohio and the other states in which

it did business. It characterized the balance of its income as being from nonunitary investments and, therefore, not apportionable. In calculating these amounts, AHP used a formula which was based on the ratio of the lowest weekly balance of investment securities to the average weekly balance of such securities:

(a) $\frac{\text{Lowest Balance}}{\text{Average Balance}} \times \text{Interest Income} = \text{Nonunitary Investment Income}$

(b) $\text{Total Interest Income} - \text{Nonunitary Investment Income} = \text{Unitary Investment Income}$

AHP indicated that in using this formula it made the "assumption" that amounts above the lowest balance represented the investment of working capital and that amounts below such balance represented nonunitary investments. However, there was no restriction on AHP's use of all the short term investments and income from them as a source of working capital in its business operations, including those in Ohio. As a result, the lowest weekly "balance" of AHP's short-term investments could and did change any time AHP needed to draw on the investments as a source of capital for use in its various business operations.

In a decision and order issued on June 30, 1988, the Board of Tax Appeals determined that there was not sufficient nexus between AHP's short-term investment income and its business activity in Ohio for purposes of taxation. However, the Board held that, as an administrative agency, it was without authority to rule on the constitutional validity of a statute which required inclusion of the income in the computation of AHP's corporation franchise tax liability. The Board also rejected, on its merits, an alternate argument raised by AHP with respect to the manner in which apportionment had been made under the statute.

Both parties filed appeals to the Ohio Supreme Court. On March 7, 1990, the Ohio Supreme Court issued a decision

in which it held that AHP's manufacturing, warehousing, and selling in Ohio established a minimal connection with Ohio. It said, however, that this nexus was broken by AHP's corporate independence from the payors of the investment income. It then found that a nexus was "re-established" by AHP's use of some of the accumulated funds in its interstate business, which included operations in Ohio. However, it held that AHP's lack of need for the amounts in excess of what it had used for operational capital or to secure loans of working capital "broke the nexus again". Citing the United States Supreme Court's decision in *ASARCO, Inc. v. Idaho State Tax Commission,* 458 U.S. 307 (1982), as pivotal, the Ohio Supreme Court concluded that Ohio could not constitutionally apportion and then tax the disputed investment income.

This Petition has followed.

ARGUMENT IN SUPPORT OF ALLOWING WRIT OF CERTIORARI

SHORT-TERM INVESTMENTS OF ACCUMULATED EARNINGS SURPLUSES, WHICH A CORPORATION HOLDS AS A RESERVOIR OF CAPITAL, AVAILABLE FOR USE IN ITS UNITARY BUSINESS ACTIVITIES, ARE PART OF SUCH UNITARY BUSINESSS, IRRESPECTIVE OF WHETHER THE CORPORATION ACTUALLY USES SUCH CAPITAL. INCOME FROM SUCH INVESTMENTS IS, THEREFORE, UNITARY INCOME AND IS APPORTIONABLE TO THE STATES IN WHICH THE CORPORATION DOES BUSINESS.

The decision of the Ohio Supreme Court that the Due Process Clause of the Fourteenth Amendment of the United States Constitution bars the apportionment and taxation of AHP's "excess" short-term investment income is purportedly based on this Court's decision in *ASARCO, Inc. v. Idaho State Tax Commission,* 458 U.S. 307 (1982). However, the Ohio Supreme Court's reliance on *ASARCO* is misplaced, and its conclusion that Ohio may not constitutionally apportion the income is erroneous. Neither the Due Process Clause nor *ASARCO* preclude the apportionment and taxation of such income.

1. The Due Process Clause Permits The Apportionment Of Income From Unitary Business Activities.

In *ASARCO,* this Court considered whether the State of Idaho could include within the apportionable income of a nondomiciliary corporation dividends from partially-owned subsidiaries, interest from debentures and two notes, and capital gains on the sale of stock of two of its subsidiaries. *Id.* at 309-310. *ASARCO* owned 50% of the stock of only two of the subsidiaries in issue, and the Court found that it had not exercised control over either of those two companies. Against such background this Court determined

that the relationship of those subsidiaries to the parent fell short of a unitary business and that there was no rational relationship between the dividend income and the business activities of ASARCO within Idaho. Based on this determination, the Court rejected Idaho's attempt to apportion and tax a part of that income.

The Court did not, however, hold that a corporation's investment income could never be included in its apportionable income base under the Due Process Clause. On the contrary, this Court has recognized circumstances in which investment income might be viewed as unitary income, apportionable to states in which a corporation does business.

The first circumstance is that of investment income received from a subsidiary or affiliate which, along with the taxpayer, is part of a functionally integrated enterprise. For example, in *Mobil Oil Corporation v. Commissioner of Taxes of Vermont,* 445 U.S. 425 (1980), this Court upheld the State of Vermont's attempt to apportion and tax dividend income received by a New York corporation from foreign subsidiaries and affiliates as not violative of due process. The Court noted that the foreign activities of the subsidiaries and affiliates appeared to be part of the appellant's integrated petroleum enterprise and that, in the absence of proof of a "discrete business enterprise," the dividend income's foreign source did not destroy the requisite nexus with in-state activities. *Id.* at 439, 440. In this regard compare also *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983), reh. den. 464 U.S. 909 (1983), in which this Court reasserted the principle that a state is entitled to tax a functionally integrated enterprise as a single entity. *Id.* at 179.

In addition to the case of investment income from a subsidiary or affiliate in a functionally integrated enterprise, the Court has also recognized the unitary nature of income from the short-term investment of working capital. Such recognition focuses not so much on the relationship of the payor of the investment income to the taxpayer as on the

nature of the investment as short-term and the circumstances of such investment. As Justice O'Connor observed in her dissenting opinion in *ASARCO, supra,* at 337-338:

> ASARCO does not, and could not, contend that all its investment income is per se beyond the taxing power of the nondomiciliary States in which it operates. Rather, it concedes that the Due Process Clause permits Idaho to tax, on an apportioned basis, the income ASARCO earned on short-term investments of its working capital.[5] After all, an appropriate amount of liquid working capital is necessary to the day-to-day operation of a business, and any return earned from its temporary investment is a by product of the operation of the business. ASARCO thus admits that Idaho could tax a portion of the income realized from an investment in, say, short-term commercial paper, even though the underlying operations of the issuing companies were far less related to ASARCO's nonferrous metals business than the operations of the five subsidiaries at issue here.

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[5] ASARCO states that it "has not contested Idaho's right to treat interest income from temporary deposits of [its] working capital funds as apportionable business income derived in the ordinary course of [its] Unitary Business activities." Brief for Appellant 26. See also Tr. of Oral Arg. 6-7.

Simply put, it is necessary to look at the "underlying realities" to determine whether income is derived from a unitary business or from an unrelated business activity which constitutes a "discrete business enterprise." *ASARCO,* at 319.

Courts in a number of states have also recognized these principles. In *Sperry & Hutchinson Co. v. Department of Revenue,* 270 Or. 329 (1974), 527 P.2d 730, the Supreme Court of Oregon held that a state in which the taxpayer did business could apportion and tax income from short-term securities "held to satisfy" the need for liquid capital in the taxpayer's normal business. Such securities had been

identified as a specific portion of the taxpayer's investment portfolio and were distinguished by the Court from long-term investments and short-term investments held for future expansion.

Similarly, in *Holiday Inns, Inc. v. Olsen,* 692 S.W. 2d 850 (Tenn. 1985), the Supreme Court of Tennessee held that income derived from the short-term investment of that taxpayer's working capital was business income to be apportioned among the several states in which the taxpayer did business. The investments in question were managed by a department of the taxpayer and fluctuated in amount, depending on the taxpayer's needs. Principal and interest were expended in the business. The excess funds were placed in interest bearing securities. The court, reasoning that the investment earnings had arisen from transactions and activities in the regular course of the taxpayer's business, concluded that they were apportionable "business earnings."

In *Silent Hoist & Crane Co., Inc. v. Director, Division of Taxation,* 100 N.J.1 (1985), 494 A.2d 775, the Supreme Court of New Jersey considered whether income from the taxpayer's investment portfolio could be included by the State of New Jersey in the taxpayer's apportionable income. The taxpayer was a New York corporation, owning property in both New York and New Jersey and making sales in New Jersey and elsewhere. In addition to its manufacturing and sales the taxpayer held commercial real estate with tenants who were not related to its manufacturing operation. It also had a portfolio of investment securities, and it argued that its sales, real estate, and investment businesses were distinct and could not be taxed as a unitary business for purposes of apportioning income. The New Jersey Supreme Court disagreed.

In determining the existence of a unitary business, the New Jersey court noted that the "focus must be on Silent Hoist's investment activity and other aspects of its corporate business and the role the investment activity plays in those other activities." *Id.,* at 19. The court considered the ultimate

control of all the activities by the same chief executive officer[1] and a direct monetary flow of value from one segment of the business to another. More recently, in *NCR Corp. v. Comptroller of the Treasury,* 313 Md. 118 (1988), 544 A. 2d 764, and *M. Lowenstein Corporation v. South Carolina Tax Commission,* 298 So.C. 93 (1989), 378 S.E. 2d 272, courts in Maryland and South Carolina have cited similar factors in upholding the apportionment of income from short-term investments.

2. AHP's Short-Term Investment Income Was Derived From An Activity Which Was Part Of Its Unitary Business.

It is significant, then, that in the present case, it is undisputed that the source of the investments in question was the accumulated earnings of the business operations of AHP in various states, including Ohio. It is undisputed that these earnings were invested by a portfolio manager under the supervision of AHP's corporate treasurer. It is also undisputed that AHP used these invested surpluses as a source of working capital.[2] Indeed, there was no finding by either the Board of Tax Appeals or the Ohio Supreme Court that any portion of the short-term investments or income therefrom were committed to or ultimately used for anything other than AHP's normal business operations. Based on the source of the investments, their centralized management, and their ultimate use in the taxpayer's other business activities, AHP's short-term investments were part of a unitary business operation as that concept has been applied in the cases discussed above. Under the test enunciated by this Court in *Mobil Oil Corp., supra,* at 348, and followed in *Container Corp., supra,* at 178-179, the income from such investments

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[1] On this point see also *Russell Stover Candies, Inc. v. Dep't. of Revenue,* 665 P.2d 198 (Mont. 1983), app. dismissed 464 U.S. 988, and *Commissioner of Revenue v. Associated Dry Goods, Inc.,* 347 N.W. 2d 36 (Minn. 1984), cert. den. 469 U.S. 833.

[2] As discussed in the Statement of Case, AHP used a formula to compute that amount which it conceded to having needed and used.

was unitary income, and Ohio's attempt to apportion it did not violate the Due Process Clause.

3. The Ohio Supreme Court Has Misapplied This Court's Test Of A Unitary Business.

For its part, the Ohio Supreme Court has completely confused and misapplied this Court's pronouncements as to the nature of a unitary business and its significance in determining the effect of the Due Process Clause on the apportionability of income. As this Court observed in *Container Corp., supra,* the prerequisite to a constitutionally acceptable finding of a unitary business is a flow of value between the different segments of the business. *Id.,* at 178-179. The Ohio Supreme Court, however, has premised its finding of no unitary business on 1.) the lack of a relationship between AHP and the payors of the investment income, and 2.) the fact that AHP did not actually liquidate and use the investments in its operations during a particular year. Both premises are without foundation in either law or logic.

The lack of a relationshp between AHP and the payors of its short-term investment income, is irrelevant. The presence or absence of such a relationship has nothing to do with the determination of a flow of value between AHP's investment portfolio and its other business activities. Cf. *NCR Corp., supra,* at 139. The identity of companies in which AHP invests is no more relevant than the identity of customers who buy AHP's products. In both cases, business decisions and activities generate income which is available for use in other business activities. The relevant question is whether there is a flow of value between the two business activities sufficient to characterize them as components of a unitary business. The Ohio Supreme Court missed this point, and its emphasis on the lack of a relationship with the interest payors, completely distorts the test of a unitary business established by this Court.

The Ohio Supreme Court has also erred by accepting AHP's premise that the investments were not a part of the corporation's unitary business to the extent that they were

not actually withdrawn for use in operations during a particular year. The Ohio Supreme Court's rationale was that such lack of need broke the nexus between the short-term investments and Ohio and, presumably, the other states in which AHP does business. Under AHP's and the Ohio Supreme Court's approach, the untapped short-term investments assumed the status of a discrete business enterprise. Of course, should AHP have needed to liquidate and use more of the short-term investments for its operations during a subsequent week, the character of such investments as a discrete business enterprise would have changed, and they would have suddenly become part of AHP's unitary business.

There is absolutely no basis for such an approach to the concepts of working capital and unitary business. Working capital is not limited to the surplus that is actually used in operations during a particular period. It includes the reservoir of surplus that is uncommitted to other uses and is, therefore, held available for use as needed in a company's operation. As a pure accounting concept, "working capital" identifies the excess of current assets over current liabilities.[3] As a component of a company's unitary business operation, the investment of "working capital" means those short-term investments held to satisfy a company's need of liquid capital for its operations.[4] *Cf. Sperry & Hutchinson, supra,* at 332, 333; *Holiday Inns, Inc., supra,* at 854; *NCR Corp., supra,* at 140.

Ultimately, both the character and circumstances of AHP's short-term investments requires the treatment of them as

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[3] AICPA Accounting Research Bulletin (ARB) 43, ch. 3A, ¶3, as found in FASB Accounting Standards, Current Text, General Standards as of June 1, 1986.

[4] In *ASARCO, supra,* at 324 n. 21 this Court noted that the company had sufficient cash flow from mining to provide operating capital for all mining operations without reliance on cash flow from income from intangibles. This, of course, was not the case with AHP which admits that it regularly tapped its short-term investments as a source of funds for operations.

part of a unitary business conducted by the company. The investments were made with the surplus which AHP accumulated from its various business activities in Ohio and other states. Control over the investments was centralized in AHP's corporate offices. The investments were managed by a portfolio manager in AHP's corporate office, and such manager was under the supervision of the corporate treasurer. AHP drew on such investments to satisfy its needs for capital for its operations, and its ability to draw on this portfolio of investments was not restricted by the segregation and commitment of any part of the portfolio to some other use which might be characterized as a discrete business enterprise. Simply put, AHP's short-term investments were part of a functionally integrated business in which it generated earnings from manufacturing and marketing activities and then held these surpluses in liquid securities which were available to meet AHP's changing need for capital in its operations. There was, consequently, no basis under *Mobil Oil Corp., ASARCO,* and the other cited decisions of this Court for the Ohio Supreme Court's determination to treat a portion of AHP's short-term investment income as the product of a discrete business enterprise. The investments were part of AHP's unitary business operation, and the income from them was unitary business income, the apportionment of which is not prohibited by the Due Process Clause.

The legal standard applied in the Ohio Supreme Court's decision in this case is contrary to that applied in the decisions of both this Court and courts of last resort in other states. If allowed to stand it would impose on Ohio a significantly more rigid constitutional due process restriction than is required by this Court's decisions and is recognized by other state courts. It would constitutionally preclude Ohio from apportioning and taxing income from investments which are clearly a functionally integrated component of AHP's multistate business operations. One constitutional standard would be applied to Ohio while another, less restrictive, constitutional standard would be applied to other states. Because of these conflicts and the potential impact of the Ohio Supreme Court's decision, it is essential that this Court

grant this Petition and reaffirm the rights of the states to apportion and tax such income.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Supreme Court of Ohio.

Respectfully submitted,

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ATTORNEYS FOR PETITIONER
JOANNE LIMBACH,
TAX COMMISSIONER OF OHIO

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the requisite number of copies of the foregoing Petition for Writ of Certiorari has been served on the respondent by forwarding such copies to Roger F. Day, of Jones, Day, Reavis & Pogue, 1900 Huntington Center, 41 South High Street, Columbus, Ohio 43215, counsel for respondent, by United States mail, first-class postage prepaid, this _____ day of June, 1990. I further certify that all parties required to be served have been served.

JAMES C. SAUER
Assistant Attorney General
Counsel of Record

APPENDIX

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NOS. 88-1252 and 88-1318

THE SUPREME COURT OF OHIO

AMERICAN HOME PRODUCTS CORPORATION,
APPELLANT AND CROSS-APPELLEE, v.

LIMBACH, TAX COMMR.,
APPELLEE AND CROSS-APPELLANT.

OPINION

Decided and Filed March 7, 1990

APPEALS
from the Board of Tax Appeals

American Home Products Corporation ("AHP"), appellant and cross-appellee,[1] a Delaware corporation with headquarters in New York, manufactures and markets prescription drugs, medical supplies, packaged medicines, foods, household products, and housewares. In franchise tax return years 1980 through 1983, AHP manufactured products at four Ohio plants and stored the products in various Ohio warehouses. It also operated sales offices in four Ohio cities.

In these tax years, AHP invested accumulated funds in short-term investments — certificates of deposit, commercial paper, and government obligations. Usually, it rolled these securities over into new and similar investments when the old ones matured. AHP also sold various investment securities as market conditions and other factors dictated.

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[1] Although the BTA affirmed her order, the commissioner filed a cross-appeal because she disagreed with the BTA's nexus finding, which according to the commissioner, could be the basis for reversal if the statute's application is held to be unconstitutional. She also gleaned that the BTA made a finding that she had the burden to establish a sufficient nexus, and she also appeals this question.

AHP acquired, managed, and controlled these investments in New York by its portfolio manager, who was under the supervision of AHP's treasurer. AHP received, managed, and controlled the investment income in New York and held the investment securities in a New York bank vault. AHP had no organizational relationship with the obligors/payors and was independent from them. Moreover, AHP did not pledge any investment securities as security to borrow working capital, to acquire stock in other companies, or to support any bond or other financing issue of AHP.

However, AHP spent some of these accumulated funds for operations. AHP devised a formula to calculate the amount of the funds which were in excess of funds spent for operations or investments of working capital. It subtracted this excess, which it called "non-unitary investment income," from total investment income to ascertain "unitary investment income." AHP apportioned only this unitary investment income according to the statutory formula, and paid franchise tax on the amount apportioned to Ohio.

The Tax Commissioner, appellee and cross-appellant, however, audited AHP's returns and apportioned all the investment income, resulting in a larger amount being apportioned to Ohio. On appeal to the Board of Tax Appeals ("BTA"), AHP argued that the Due Process A-4 Clause prohibited Ohio's taxation of the non-unitary investment income. The BTA found that AHP did not use any portion of the non-unitary investments and securities as security to borrow working capital or directly as operational capital. Nevertheless, the BTA found, under R.C. 5733.05(B), that all investment income should be included in apportionable income. Furthermore, it found that, as an administrative agency, it lacked jurisdiction to address the constitutional challenge which AHP had presented. Consequently, the BTA affirmed the commissioner.

These causes are now before this court upon appeals as of right.

Jones, Day, Reavis & Pogue, Roger F. Day, for appellant

and cross-appellee.

Anthony J. Celebrezze, Jr., attorney general, and *James C. Sauer*, for appellee and cross-appellant.

PER Curiam. Ohio levies the franchise tax on foreign corporations for the privilege of doing business in Ohio, owning or using a part or all of its capital or property in Ohio, or holding a certificate authorizing it to do business in Ohio. R.C. 5733.01(A). Ohio levies the tax on the net worth or net income basis, whichever produces the greater tax. R.C. 5733.06. This appeal concerns the net income basis.

Ohio allocates some income entirely to Ohio under R.C. 5733.051, generally according to the situs of property producing it. Ohio apportions unallocated income under former R.C. 5733.051(A)(8) (now 5733.051[H]) and R.C. 5733.05(B) by the three-factor (now four-factor) apportionment formula of R.C. 5733.05(B). The apportionment formula attempts to attribute to Ohio the extent of the corporation's business activity in Ohio and to fairly tax the foreign corporation for the privilege of engaging in business in Ohio. *R.H. Macy & Co. v. Lindley* (1986), 25 Ohio St. 3d 218, 219, 25 OBR 279, 280, 495 N.E. 2d 948, 950.

AHP argues that the Due Process Clause of the federal Constitution prohibits Ohio from taxing the investment income because the investment activity producing the income took place entirely outside Ohio and because the payors were discrete business entities within the meaning of *Mobil Oil Corp. v. Commr. of Taxes of Vermont* (1980), 445 U.S. 425, and *ASARCO, Inc. v. Idaho State Tax Comm.* (1982), 458 U.S. 307. The commissioner responds that the income was available as working capital, even though it was not needed, and apportioning the income to Ohio did not violate the Due Process Clause.

We hold that AHP's manufacturing, warehousing, and selling in Ohio established a minimal connection with Ohio. AHP's corporate independence from the payors of the investment income broke this nexus for the investment

income. AHP's use of some of the accumulated funds in its interstate business re-established a nexus because AHP spent the money to foster its interstate business, of which Ohio was a part. However, AHP's proven lack of need for the amount in excess of operational capital or to secure loans of working capital broke the nexus again. Thus, AHP established that no relationship existed between this excess amount and its Ohio business. Consequently, we hold that Ohio may not constitutionally apportion and then tax the disputed investment income.

In *Mobil Oil Corp. v. Commr. of Taxes of Vermont, supra,* the United States Supreme Court reaffirmed the established principle that a state may tax a corporation's income if the income is fairly apportioned to the state. Under the Due Process clause of the Fourteenth Amendment, a state may tax such income if there is a nexus, *i.e.,* a minimal connection, and a rational relationship between the income attributed to the state and the intra-state values of the enterprise. *Id.* at 436-437. Sufficient nexus exits "* * * if the corporation avails itself of the 'substantial privilege of carrying on a business'within the State * * *." Events that generate income, and that occur outside the state, do not necessarily break the nexus. *Id.* at 437. According to the court, the appellant, to break the nexus, must establish that the income was earned in the course of activities unrelated to the state, a proof of a discrete business enterprise. *Id.* at 439-440. The court concluded its analysis, at 441-442, with this statement:

"We do not mean to suggest that all dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where that corporation does business. Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability because there would be no underlying unitary business."

In *ASARCO, Inc. v. Idaho State Tax Comm., supra,* the court declared unconstitutional the apportioning of dividends, interest payments, and capital gains received for

the ownership interest in corporations in which ASARCO owned major interests, which had no other connection with the state and which ASARCO either could not control or could have controlled but did not. The court stated: "* * * a State may not tax value earned outside its borders." The court said the question was "* * * 'whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.' " *Id.* at 315, quoting *Wisconsin v. J.C. Penney Co.* (1940), 311 U.S. 435, 444.

The *ASARCO* court ultimately distinguished *Mobil Oil Corp.* because Mobil's principal dividend payors were part of Mobil's integrated petroleum business and ASARCO's payors were not. The *ASARCO* court seized on *Mobil Oil Corp's* cautioning that all dividend income is not necessarily taxable in each state where that corporation does business. The court reasoned that since ASARCO's subsidiaries had nothing to do with ASARCO in the taxing state, they were discrete business enterprises. The *ASARCO* court, responding to the dissent's argument that ASARCO may use the income for its future operations, pointed to the trial court's finding that ASARCO never had to use the stock as security to borrow working capital, to acquire stock or securities in other companies, or to support any bond issues. Furthermore, ASARCO, according to the trial court, had sufficient cash flow from its mining operations to provide operational capital for its mining and did not rely upon the cash flow from the investment income. *Id.* at 324-325, fn. 21.

The court rejected Idaho's contention that any intangible income should be apportioned if it is acquired, managed, or disposed of for any purpose relating to or contributing to the corporation's business. The *ASARCO* court, at 326, stated:

"This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations,

including any investment made, in some sense can be said to be 'for purposes related to or contributing to the [corporation's] business.' When pressed to its logical limit, this conception of the 'unitary business' limitation becomes no limitation at all. when less ambitious interpretations are employed, the result is simply arbitrary." (Emphasis *sic.*)

In summary, the court held that ASARCO did not actually exercise potential control over the subsidiaries and that they were discrete business enterprises that, in a business or economic sense, had nothing to do with ASARCO's activities in Idaho. "Therefore, there is no 'rational relationship between the [ASARCO dividend] income attributed to the State and the intrastate values of the enterprise. * * *' " *Id.* at 328.

Thus, we must decide whether AHP's interstate activities have a minimal connection with Ohio and whether a rational relationship exists between the income sought to be attributed to Ohio and the intrastate values of the enterprise.

Our reading of ASARCO's footnote 21, at 324-325, proves pivotal in the instant case. The *ASARCO* court noted that the investments were not used as security to borrow working capital, to acquire stock or securities in other companies, or to support any bond issues. It also noted that *ASARCO* had sufficient cash to operate without relying on the income from the investments. Therefore, under ASARCO, if AHP does not use the securities to secure loans of working capital or need the funds to operate its business, the funds should not be apportioned. These findings are factual.

The BTA found that AHP did not pledge the investments to secure loans of working capital and that it did not require the funds directly for operational capital. These findings are supported by an affidavit which the BTA, without objection by the commissioner, admitted into evidence. These factual findings are, thus, based on sufficient probative evidence, and we may not overrule them. *Hawthorn Mellody v. Lindley* (1981), 65 Ohio St. 2d 47, 19 O.O. 3d 3234, 417 N.E. 2d 1257. Consequently, Ohio may not constitutionally tax the "non-unitary" portion of the investment fund.

As for the commissioner's cross-appeal, she argues that the BTA improperly placed on her the burden to prove that a nexus existed. Indeed, the taxpayer has the burden to prove a lack of nexus. Yet, the commissioner must rebut evidence which breaks the nexus. We conclude that AHP proved the lack of a nexus and that the commissioner did not rebut this proof. We also conclude that the BTA did not burden the commissioner with proving that a nexus existed, but that it found that the commissioner had not rebutted the evidence breaking the nexus.

Accordingly, as to AHP's appeal, we hold that the BTA's decision is unlawful and reverse it. As to the commissioner's cross-appeal, we hold that the BTA's decision is reasonable and lawful and affirm it.

Decision affirmed in part and reversed in part.

MOYER, C.J., SWEENEY, HOLMES, DOUGLAS, WRIGHT, H. BROWN and RESNICK, JJ., concur.

BOARD OF TAX APPEALS
STATE OF OHIO

American Home Products Corporation,
Appellant,

vs. Case Nos. 87-J-95, 87-B-96, 87-A-97, 87-F-98 87-A-99

Joanne Limbach,
Tax Commissioner of Ohio,
Appellee. (FRANCHISE TAX)

DECISION AND ORDER

Filed June 30, 1988

REPRESENTATIVES:

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By: Roger F. Day, Esq.
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These causes and matters came on to be considered by the Board of Tax Appeals upon five notices of appeal filed herein under date of February 5, 1987, by the appellant named above. These appeals are from five final orders of the Tax Commissioner each dated December 26, 1986, relating to franchise tax assessments for return years 1980, 1981, 1982 and 1983. The notices of appeal and the final orders of the Tax Commissioner are incorporated herein. On September 9, 1987 the matters were consolidated for purposes of hearing

and disposition.

The matter was submitted to the Board of Tax Appeals upon the notices of appeal, the statutory transcripts furnished by the Tax Commissioner, the evidence adduced at the evidentiary hearing held herein, and the briefs filed by counsel for the parties.

The appellant is a Delaware corporation which has its general corporate office in New York, New York. Its principal business activity consists of the manufacture and sale of prescription drugs, medical supplies, packaged medicines, foods, household products, and housewares. Appellant transacts business in over twenty five states including Ohio. Appellant has conceded that during the years in question it manufactured products in Ohio warehouses, and operated sales offices in four Ohio cities. Appellant has further conceded that a portion of its investments represented working capital and that income derived from investment of its working capital was properly apportioned to Ohio.

The appellant has objected to the Tax Commissioner's assessment of its short-term investment activity. During the years in question the appellant accumulated funds which were not required for working capital or for operational purposes. Appellant invested these funds in certificates of deposit, commercial paper, and government obligations. The securities were acquired, managed, and controlled from appellant's offices in New York City. The income from the securities was received, managed and controlled from the same location. The securities themselves were physically held in a vault at Manufactuers Hanover bank in New York City. During the years in question the appellant did not use any portion of the investment securities as security for borrowing working capital, or operating capital, or as security for acquiring stock in other companies, or to support any bond or other financing issue of the appellant.

The franchise tax scheme is provided in Revised Code Chapter 5733. Essentially, it requires that a corporation pay franchise tax on either its net income or net worth, whichever

is greater. During the years in question the appellant filed its franchise tax reports on the net income basis.[1]

Appellant initially contends that the interest income and capital gains earned from its New York investments should be excluded from its net income calculated for purposes of determining its Ohio franchise tax base. Appellant does not contend that Ohio has no statutory basis to include this investment income. It is clear that section 5733.05 requires its inclusion. However, appellant argues that the due process clause of the fourteenth amendment of the United States Constitution prevents Ohio from taxing appellant's interest income and capital gains when the investment activity which gave rise to this income took place entirely outside Ohio.

The Board of Tax Appeals is an administrative agency. As such, it is without jurisdiction to determine the

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[1] Revised Code section 5733.05 provides in pertinent part:

"(B) The sum of the corporation's net income, during the year or portion thereof preceding the date of commencement of its annual accounting period that includes the first day of January of the tax year, allocated or apportioned to this state as follows:

"(1) The net income allocated to this state as provided by section 5733.051 (5733.05.1) of the Revised Code;

"(2) The amount of Ohio apportioned net income from sources other then those allocated under section 5733.051 (5733.05.1) of the Revised Code, which shall be determined by multiplying the corporation's net income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor plus sales factor, and the denominator of which is four, provided that the denominator of four shall be reduced by the number of fractions which have a denominator of zero. The property, payroll, and sales factor shall be determined as follows:

"(a) The property factor is a fraction the numerator of which is the average value of the corporation's real and tangible personal property owned or rented, and used in the trade or business in this state during the taxable year, and the denominator of which is the average value of all the corporation's real and tangible personal proper owned or rented, and used in the trade or business everywhere during such year. . .

"(b) The payroll factor is a fraction the numerator of which is the total amount paid in this state during the taxable year by the corporation for compensation, and the denominator of which is the total compensation paid everywhere by the corporation during such year."

constitutional validity of a statute. *S.S. Kresge Co. v. Bowers* (1960), 170 Ohio St. 405. However, a party that challenges the constitutionality of the application of a tax statute in a particular situation is required to raise that challenge at the first available opportunity during the proceedings before the Tax Commissioner, and a failure to do so constitutes a waiver of that issue. *Bd. of Edn. of South-Western City Schools v. Kinney* (1986), 24 Ohio St. 3d 184. This principle was reiterated and expounded upon in *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St. 3d 299 where the Court held that the Board of Tax Appeals must receive evidence concerning this question if presented, even though this Board may not declare the statute unconstitutional.

The appellant herein has complied with these decisions. It raised the constitutional issue at the proceedings before the Tax Commissioner. A record upon which a reviewing court may review this challenge has been made. Therefore, this issue has been preserved should this matter be appealed. In conjunction with this issue the Board finds that the facts as stated in the statutory transcripts, and appellant's exhibit "A", which have been restated herein are true.

In addition to the constitutional issue the appellant urges modification of appellee's final determination on an alternative basis. Appellant contends that the Ohio franchise tax is a tax on the fair value of business done in Ohio. However the appellant's interest income does not result from any business activity conducted in this state. The Board agrees that the interest income is generated entirely outside Ohio. Appellant is a Delaware corporation headquartered in New York. A sufficient nexus with Ohio for purposes of taxation has not been established by appellee.

In *R.H. Macy & Co. v. Lindley* (1986), 25 Ohio St. 3d 218 the taxpayer was a New York corporation. One of its subdivisions operated in Ohio. Each subdivision operated autonomously. The taxpayer filed its franchise tax reports under the net income method by means of a separate accounting because it contended that the allocation and apportionment method of sections 5733.05 and 5733.051 did

not fairly represent the extent of its business activity in Ohio.

The Ohio Supreme Court held that for franchise tax purposes, Ohio law assumes that the apportionment formula outlined in section 5733.05 fairly represents the extent of a foreign corporation's business activities in this state. This presumption, however, is rebuttable.[2] It is incumbent upon the taxpayer to show that an alternative method more accurately represents the portion of its income which is properly allocable and apportionable to Ohio.

Revised Code section 5733.05(C) provides in pertinent part:

> "Sales, other than sales of tangible personal property, are in this state if either;
>
> "(i) The income producing activity is performed in this state;
>
> "(ii) The income-producing activity is performed both within an without this state and a greater proportion of the income-producing activity is performed within this state than any other state, based on costs of performance."

The appellant's alternative argument is that should a reviewing court decide that the apportionment formula is constitutional as applied herein, nevertheless the Tax Commissioner should have included the receipts from the sales of its intangibles in the sales factor. In support of this

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[2] Revised Code section 5733.05 provides in pertinent part:

"(d) If the allocation and apportionment provisions of division (B) of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may request, which request must be in writing and must accompany the report, or the tax commissioner may require, in respect to all or any part of the taxpayer's allocated or apportioned base, if reasonable, any one or more of the following:

"(i) Separate accounting;

"(ii) The exclusion of any one or more of the factors;

"(iii) The inclusion of one or more additional factors which will farily represent the taxpayer's allocated or apportioned base in this state.

"An alternative method will be effective only with approval by the tax commissioner."

contention appellant relies upon *Illinois Tool Works, Inc. v. Lindley* (1981), 70 Ohio St. 2d 175. In that case the Ohio Supreme Court addressed the issue of whether the sale of treasury bills purchased at discount and subsequently sold at par must be included in the sales factor pursuant to Revised Code Section 5733.05(B)(2)(c). The Court held that the sale of intangibles do enter into the sales factor because they are specifically allocated under sections 5733.051(A)(1) through (A)(7).[3]

It should be noted that *Illinois Tool Works* does not address the question of whether receipts which do not result from a sale should be allocated under 5733.051(A) through (A)(7). The issue of whether the earning of interest was a sale was not before the Court. This issue was addressed in *Gulf Oil Corp. v. Kosydar* (1975), 44 Ohio St. 2d 208. In that case the Court held that as applied to a taxpayer whose business consists both of making sales of tangible personal property, and other activities such as receiving interest and dividends, section 5733.05 requires the Tax Commissioner to compute the business done apportionment fraction by reference to

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[3] During the period at issue herein section 5733.051 provided in pertinent part:

"(A) Net income of a corporation subject to the tax imposed by this chapter shall be allocated and apportioned to this state as follows:

"(5) Capital gains and losses from the sale or other disposition of intangible personal property which may produce income enumerated in subdivision (6) of this division shall be allocated on the same basis set forth in such subdivision. (sic) Capital gains and losses from the sale or other disposition of all other intangible personal property shall be allocated on the basis of commercial situs:

"(6) Dividends, which are not otherwise deducted or excluded from net income, shall be apportioned to this state in accordance with the ratio which the book value of the physical assets of the payor thereof located in this state bear to the book value of the total physical assets of the payor thereof located everywhere. Dividends received from payors, the location of whose physical assets is not available to the taxpayer, shall be apportioned as provided in subdivision (8) of this division;

"(8) Any other net income, from sources other than those enumerated in subdivisions (1) to (7), inclusive, of this division, shall be allocated to this state on the basis of the apportionment mechanism provided in division (b) of section 5733.05 of the Revised Code."

the total value of the taxpayer's business in and out of Ohio according to situs.

In *Gulf Oil* the Court acknowledged the fact that section 5733.05 does not clearly set out how a corporation which earns income from intangibles should treat this income for purposes of the franchise tax. Given this fact,the Court fashioned a remedy to be applied to corporations which have passive and active income both within and without this state.

However, the appellant's income herein is attributable entirely to investment activity which occurred outside the state. Sections 5733.05 and 5733.051, and the relevant decisions construing these sections do not directly address this issue. In deciding that the income was taxable, the Tax Commissioner looked to her Special Instruction 20 which provided that: "The sales factor of the net income valuation computation shall include gross receipts from sales not specifically allocated under divisions (A)(1) through (A)(7) of Section 5733.051, Revised Code." Section 5733.05(B)(2)(C) during the period at issue herein, provided a mechanism for determining the situs of "sales, other than sales of tangible personal property."

The appellant has not alleged nor has it proven that the Tax Commissioner's determination of situs was not done in accordance with the applicable statutes and rules. Appellant does assert that should the Board find that the interest is properly includable in its income base, then the Tax Commissioner should recognize appellant's business activity in New York which generated the income. However, the statutes clearly do not require such recognition. Therefore, absent a finding that the statutes are unconstitutional as applied to the appellant, this Board cannot hold that the Tax Commissioner improperly applied its franchise tax scheme to the business activity of the appellant.

Therefore, the final determination of the Tax Commissioner is hereby affirmed.

I hereby certify the foregoing to be a true and

correct copy of the action of the Board of Tax Appeal of the State of Ohio, this day taken, and with respect to the above styled matter.

/s/ Randall W. Sweeney Chairman